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Abstract

This article deals with the influence exercised by the efficient market hypothesis on standard setting and, consequently, its normative consequences. It shows this influence through the analysis of a particular case: the design and implementation of the International Accounting Standard on financial instruments. In this case it is clear that the efficient market hypothesis was used as the main theoretical reference to justify the use of fair values for financial instruments. By implementing such a standard the users of this standard are educated to believe that the efficient market hypothesis is the correct theoretical reference for accounting valuations. Hence an axiom of a positive research programme acquires a normative aspect. Users will take it for granted that accounting should be interpreted with reference to the efficient market hypothesis.

Key words: standard setting, accounting for financial instruments, fair value, normative consequences, efficient market hypothesis, positive theory

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1. Introduction

This article deals with the influence exercised by the efficient market hypothesis on standard setting and, consequently, its normative consequences. It shows this influence through the analysis of a particular case: the design and implementation of the International Accounting Standard on financial instruments. It is shown how the efficient market hypothesis was used as the main theoretical reference to justify the use of fair values for financial instruments. By implementing such a standard the users are educated to believe that the efficient market hypothesis is the correct theoretical reference for accounting valuations. Hence an axiom of a positive research programme acquires a normative aspect. Users take for granted that accounting should be interpreted with reference to the efficient market hypothesis.

Unlike natural laws, which remain unaffected by human activities, accounting standards are created, maintained and changed by human efforts. The standard setter's role is to make decisions and choices among alternative accounting practices, thus their decisions may affect the welfare of others (Gaa, 1988, p.xxi). The standard setter's decisions do not guarantee that standards successfully regulate accounting behaviour. Uses of standards depend upon the users' willingness to accept and use them (Brunsson *et.al.*, 2000). This is why being successful in teaching and educating is an important part of any standard setters' job.

The empirical materials of this paper are obtained from the development of accounting standards for financial instruments in the 1990s, in which traditional historical cost accounting is progressively replaced by fair value accounting[1]. Accounting for Financial Instruments is closely related to the development in financial markets that has changed dramatically over the last few decades. The development in financial markets is made possible by the de-regulatory efforts of states (Moran, 1991) and individuals (Melamed, 1996), many of whom express overt associations with neo-liberal ideology[2]. The development is also fueled by advances in financial theory and "Rocket Scientists" in Wall Street (Whitley, 1986, Young, 2001). This case provides us insights into the relationship between research and practice in

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[1] IAS no. 16 defines that "fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction (IASC, 1982, par.6). APBS no.4 defines fair value in the following way. "Fair value is the approximation of exchange price in transfers in which money or money claims are not involved. Similar exchanges are used to approximate what the exchange price would have been if an exchange for money had taken place." (AICPIA, 1970). In both cases, fair value is defined as the hypothetical approximation of exchange price for non-monetary consideration. The value-laden term "fair" in these definitions refers to the procedural appropriateness of pricing. Whereas the notion of "fairness" is conceptualized on the ground of *ex ante* and *ex post* equality (e.g., Rawls 1971: 76-80), the notion of "fairness" in "fair value" is more closely related to *ex ante* "equality of opportunity" concept, but less to *ex post* "equality of results" concept.

[2] Milton Friedman helped the chairman of the Chicago Mercantile Exchange to set up a new currency future market (Melamed, 1996).

accounting, albeit the focus of practice is limited to a level of standard setting[3].

This paper aims at understanding the normative significance of research via changing accounting standards for financial instruments. It will be shown that positivistic research that assumes market efficiency, which is sometimes referred to as "Market Based Accounting Research" (Kothari, 2001), has become the theoretical referent for the standard setters[4]. Documents issued by the International Accounting Standards (IASC) and other groups that are explicitly aiming at creating global accounting standards, as well as materials obtained from interviews with standard setters, [5] are examined in this paper. The remainder of this paper is organized as follows: the next section briefly summarizes previous research on the relationship between accounting research and accounting practice. Next, the development of financial instrument project at the IASC is outlined. It is followed by an analysis of the logic of the comprehensive fair value measurement model that clarifies the pivotal role of the efficient market hypothesis (EMH). Lastly, the usefulness of value relevance research is critically analysed and a final conclusion is presented.

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[3] As will be discussed in the following sections, the efficient market hypothesis has become a part of theoretical foundations of changing accounting standards. Similarly, in the latter half of 1980s, efficient market hypothesis has influenced legal rules in the United States. See for instance, Hazen (1996, pp.806-816) and Shulman (1989).

[4] The title of the paper is somewhat misleading because it refers to "Efficient Capital Market Research" instead of "Market Based Accounting Research". Kothari, (2001) the empirical branch of the Efficient Capital Market Research, pursues the testing of the validity of the efficient market hypothesis in real markets, whereas the Market Based Accounting Research studies the relationship between accounting numbers and stock returns assuming the efficiency of the market. According to Kothari's classification, this article is critically analysing the normative consequences of Market Based Accounting Research, therefore it is less confusing if the title of the paper would be "Normative Consequences of Market Based Accounting Research" from a positivistic researcher's point of view. However, the empirical materials of the paper show that the standard setters used the term "Efficient Capital Market Research" instead of "Market Based Accounting Research" as will be shown in the following sections. The title of the paper was deliberately chosen to reflect the entangled twists between theory and practice. Thanks to Marco Trombetta for his comments on this point.

[5] Eleven interviews were conducted from March to September 2001 in the UK and Canada. We interviewed both high ranking officials and relatively junior staff. Among the fifteen interviewees, eight of them are (were) board members of the IASC. Usually an interview lasted for about one and half hours. One interview in Canada in particular lasted almost four hours. Each interviews had a semi-structured format.

2. Accounting Research and Accounting Practice

The relationship between accounting research and accounting practice is ambiguous and complex[6]. Although there have been pleas for more research that is relevant to accounting practices[7], and increasing number of research projects motivated by practical relevance have appeared in recent years[8], the processes through which accounting research is reflected in practice, and *vice versa,* is not very well understood. The role of accounting research in standard setting is no exception. The desirability of relevant accounting research for standard setting and standard setting based on rigorous research is more often presumed than specifically analysed.

Normative significance of accounting research in standard setting has been a relatively neglected area of research, though normative decisions that are required for standard setting are well acknowledged among researchers (Gaa, 1988, Shipper, 1994). However, as the possibility that theories might not only reflect but also produce and reproduce the contexts in which accounting operates is more widely acknowledged (Burchell et.al., 1985, Chua, 1986), "increasingly accounting change is coming to be seen in terms of a process that can quite positively value and utilise certain types of ideas and knowledge" (Hopwood, 1988, pp.551-552). This recognition of the constructive role of accounting research is fostered by the evolution of institutional context of accounting which has come to establish specialised bodies for the standardization of accounting rules used in enterprise reporting, which are located between the profession and the State (Hopwood 1988: 562-563).

Hopwood (1994, p.248) pointed out that "(o)ne of the most surprising aspects about the international accounting policy arena is the absence of the voice of capital market users." He argued that users are represented rhetorically rather than substantively in person. One of roles of abstract theories in the standard setting processes is closely related to the rhetorical representation of users. Abstract theories that encompass the relationships between accounting information and information users may provide frames of reference for the rhetoric to be meaningful.

The normative origins of positive theories have been discussed by Tinker *et. al.* (1982)[9], which

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[6] The dichotomy between accounting research and accounting practice is not unproblematic. Both involves varying degree of abstraction and specificity, as well as of practice and discourse. Accounting standard setting could be seen as both. This paper follows the tradition in accounting literature that usually classifies standard setting as practice.

[7] Concise summary of those pleas in the 1980s UK, see Hopwood (1988), and in the 1990s US, see for example, Beresford & Johnson (1995).

[8] Holthausen & Watts (2000) surveys capital market research motivated by standard-setting purpose.

[9] The term "positive theories" in accounting research may be used narrowly as a synonym of a particular school, and broadly to accounting research that owe intellectual allegiance to the Chicago view. If the term is used narrowly, the referent is Positive Accounting Theory, which is sometimes called the Rochester School (Watts and Zimmerman 1978, 1979, 1986, 1990). If used broadly it is the majority of North

has revealed normative and value-laden origins of positive theories through the historical study of economic theories behind the development of accounting thought[10]. The commitment to marginalism and subjective theory of value by accounting thought is found in its emphasis on individualism and the impartial objective role of accounting as record keeping. They argue that these emphases mask the conservative role played by accounting theory and by theoreticians. Tinker *et. al.* (1982) criticize that the pretence of value-free theorizing, which is cultivated by taking market phenomena as "natural" and "universal", made it difficult to consider the role of accounting in social order and control.

The main thrust of Tinker *et. al.* (1982) is the inability of positive theories to address a certain type of question by adhering to, and not questioning, the basic normative assumptions of marginalism. In response to the criticism raised by Tinker et. al. (1982), Watts & Zimmerman (1990) respond that all research is value-laden because of the discretion researchers have over research design, such as the choice of topics to investigate, the methods to use, and the assumptions to make[11]. And they defend themselves that "(t)he usefulness of positive theories depends on their predictive and explanatory power and on the users' preferences or objective function." (Watts & Zimmerman 1990: 146).

Watts & Zimmerman (1990) makes a very clear distinction between positive research whose main objective is to explain and predict, and normative research which is concerned with prescription. Holthousen & Watts (2001) cautions premature interpretations of positive research for prescriptive purposes. As a consequence, the term "positive" avoided debates over normative uses of the work (Watts & Zimmerman, 1990, p.148). Inability of positive theories that Tinker *et. al.* (1982) criticizes is methodologically justified by Watts & Zimmerman (1990).

However, the methodologically justified absence of the reflections over its normative significance in positive theories does not guarantee that positive theories and their outputs are immune from normative use and abuse. Positive theories are not disconnected from outside world. Their outputs are

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American empirical accounting research (Whittington 1987:331). Most critiques of positive theory in accounting from the philosophy of science perspective (cf., Tinker *et. al.*, 1982, Christenson 1983, Hines 1988) tend to employ the broader definition, though the dominant usage in the North American context seems to be the narrow definition. This paper employs the broader definition. Postive Accounting Theory, Market Based Accounting Theory, and Efficient Capital Market Research, which are distinct bodies of research relatively independent from, and sometimes quite antagonistic to, each other, are examples of positive theories in accounting research.

[10] In his recent auto-critique of *Paper Prophet* (Tinker 1999) whose theoretical part is largely based on Tinker, *et.al.* (1982), he recognized that the link between the empirical materials and theory was rather weak. This raises some fundamental methodological questions, nevertheless it does not mean that the importance of normative origins should be underestimated.

[11] The reply only partially reflects historical criticism of Tinker *et. al.* (1982), because it is the systematic discretionary choices of seemingly independent researchers that have normative origins.

circulated in the standard-setting arena. The way in which positive theories and their outputs are used in the standard setting processes is beyond positivist control. The way in which objective functions of users may or may not be affected by the development in positive theories is also beyond positivist analytical framework[12].

This paper approaches the normative aspects of Market Based Accounting Research , which is referred by the standard setters as "efficient capital market research", from their possible consequences rather than from their origins. Tinker *et. al.* (1982) is concerned with the inability of positive theories to question certain types of agendum; we are more concerned with the power of positivistic research to influence social interactions that might succeed in embedding its axiomatic assumptions in society.

3. The Financial Instrument Project at the IASC

In this section, an overview of standard setting activities of the financial instrument project at the IASC is chronologically described to set the scene. Next the history of the project is tentatively divided into two stages: the first stage from 1989 to 1995, and the second stage from 1996 to 2000. Each stage is characterized by distinctive standard setting approaches employed by the steering committees.

3.1. Overview of the Financial Instrument Project

The financial instrument project at the IASC started in 1989 (Cairns 1999, Skinner & Milburn 1999). A steering committee on financial instruments was set up by the IASC jointly with the Canadian Institute of Chartered Accountants (CICA) in 1989[13]. Staff members of the committee were provided by the CICA. The Steering Committee was comprised of the representatives from Australia, Canada, Holland, Italy, France, Japan, UK and US[14]. The first chairman was an American representative. The aim of the steering committee was to prepare a comprehensive standard for all financial instruments by providing general principles for recognition, measurement and disclosure of financial assets and financial liabilities. This steering committee produced two exposure drafts for the Accounting for Financial Instruments; E40 "Financial Instruments" (1991) and E48 "Financial Instruments" (1994). Only the disclosure part of the E48 was authorized by the IASC board as E32 "Financial Instruments: Disclosure and Presentation" (1995), and the recognition and measurement part was separated and dealt with by a new steering committee (hereafter, the second steering committee).

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[12] Watts & Zimmerman (1990) assumes that objective functions are independent from the development of positive research. The assumption should be tested empirically. Watts & Zimmerman (1982) does not provide any empirical evidence that supports this assumption.

[13] The official name of the committee is "the International Accounting Standards and Canadian Institute of Chartered Accountants Steering Committee on Financial Instruments".

[14] The main reference source of the development of the financial instrument project at the IASC in this paper is various reports written by Japanese representatives to the steering committee in the *JICPA* journal.

The first steering committee was replaced by a new steering committee in 1995. The second steering committee was comprised of Australia, Canada, Holland, Japan, Switzerland, UK and US. Staff members were again provided by the CICA. An advisory committee was formed to get opinions from a wider audience including accounting practitioners and regulators (Sakamoto 1996: 98). Members of the advisory committee included representatives from IOSCO, BIS, SEC, FASB and ASB.

The second committee members agreed to prepare a comprehensive document that covered all financial instruments by the end of 1996. The purpose of the document was to provide a basis for discussions between preparers of accounting information, users, auditors, and standard setters, and to reach consensus on issues pertaining to reporting for financial instruments (Sakamoto, 1995, p.99). The document was published as an IASC/CICA discussion paper "Accounting for Financial Instruments and Financial Assets" (IASC/CICA DP) in March 1997.

The IASC board decided in November 1997 to draw a provisional standard for financial instruments that covered recognition and measurement, and a new committee would deal with a more harmonized international standard for financial instruments separately from the provisional standard. The provisional standard was based on the FASB standard and E48. The new committee had members from FASB, CICA, ASB, AcSB, CNC, representatives from Norway, Germany, Japan, and six IASC board members. The chairman of the committee was again a representative of CICA. The committee was now known as the JWG, which is an abbreviation of the "Financial Instruments Joint Working Group of Standard Setters"[15].

3.2. Inductive Approach: in Search of the Best Mixed-attributes Measurements Model

The first steering committee started working on the basis of the "Draft Statements of Principles on Financial Instruments" prepared by the CICA members (Kato, 1990a, p.88). The first steering committee took an inductive approach to the draft standards. Distilling the best practices was the preferred approach for most of the project members.[16] At this stage of the financial instruments project, the goal of the project was to find the best possible combination of historical cost and fair value measurements, i.e., in search of the best mixed-attributes measurements model was perceived as their task. A participant commented that "(i)n the beginning, I believed that we could improve the mixed-attributes measurements model."[17] Although they found a huge diversity of practices, the approach was dominant until they started to receive comment letters on E48.

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[15] By the time the JWG issued a draft standard *Financial Instruments and Similar Items* (JWG 2000), it was emphasized that each member participated in the JWG as an individual and their opinions were of their own and did not necessarily reflect the opinions of the standard setting bodies that they belonged to or were entrusted to (Yamada 2001:18-19). This emphasis resulted from replacing the IASC by the IASB.

[16] Interview (6 September 2001).

[17] Inerview (6 September 2001).

The first two exposure drafts received comment letters that were not very supportive of the proposals for a variety of reasons[18]. For some, those mixed-attributes measurements models meant to introduce inappropriate volatility, and for others they were inconsistent with sophisticated risk management activities. Partial introduction of fair value measurement relies on the manager's intention, which seemed prone to abuse. Mixed-attributes measurements models also require highly complex and conceptually unsupportable accounting methods to represent hedge activities.

The analysis of the two sets of comment letters showed that the issues of disclosure and presentation were much less controversial than those of recognition and measurements. Consequently the IASC decided to issue separate standards on disclosure and presentation of financial instruments as IAS32. At this stage, the first steering committee was decided by the IASC board to be replaced by the second committee.

3.3. Stalemate of the Inductive Approach: Divided Constituency

When the first steering committee started to analyse comment letters on E48, they found that the content of the comments were almost the same as those on E40. Many comments disagreed on the fundamental issues that were beyond the scope of the revision that the first steering committee was assigned by the IASC board (Kato, 1995, p.107). Comment letters on E48 reconfirmed the large diversity of opinions in the IASC constituency.

The division of opinions in the constituency was recognized much earlier by the members of the first steering committee. At the London meeting in June 1993, the members of the first steering committee discussed whether they should submit the revised E40 as a proposed standard, or a revised exposure draft to the Board. The steering committee decided to submit it as a proposed standard. According to a Japanese representative of the committee (Kato, 1994, p.17), most of the members wished to conclude the then five-year long project. They also anticipated that the revised E40 would receive the same kind of divided comment letters even if it would be exposed to another round of public comments. However, the IASC board decided to re-issue the revised E40 as an exposure draft (E48) at the Oslo meeting in November 1993.

One of the reasons for the IASC board to re-issue E48 was the changing attitude of the IOSCO towards the IASC. The IOSCO had refrained from directly intervening in the standard setting processes of the IASC, though it had been an observer member of the IASC board since 1988. However, in October 1993 in Mexico City, the 1st working party of the IOSCO "suddenly changed its attitude and decided to formally recommend the IASC to re-issue the revised E40 as an exposure draft" (Kato, 1994, p.17). According to Kato (1994, p.17), this IOSCO recommendation letter to the IASC deeply influenced the IASC board's decision.

The re-issued exposure draft E48 received 158 comment letters. In October 1994, the steering

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[18] E40 and E48 received 192 and 152 comment letters respectively.

committee members met in Amsterdam to analyse the comment letters in order to decide the fate of E48. A Japanese representative commented about the meeting that "at the Amsterdam meeting, members of the committee had to make the most *bitter* decisions in the nine meetings which took place over nearly six years" (Kato, 1995a, p. 107). E48 was exposed to the public to receive comments on the points that had been altered from E40. However, most of the comments on E48 discussed issues that were beyond the scope of E48: more fundamental issues such as those related to the recognition, measurements, and hedge accounting were critically discussed in those comment letters. As was the case with comment letters on the previous E40, those on E48 showed how fundamentally divided the constituency was. At this stage, it became apparent that those comments in favor of fair value measurements came from Anglo-Saxon countries, and those in favor of historical costs from continental European countries and Japan (Kato, 1995a, pp. 108-109).

At the Amsterdam meeting, the steering committee decided to choose whether they should complete E48 as a comprehensive standard, or split E48 into two separate standards: one which dealt with each issue specifically. "It was a very tough choice for us, for the steering committee" (Kato, 1995a, 109). If E48 was to be a comprehensive standard, the unresolved fundamental issues of recognition, measurements and hedge accounting would require other supplemental standards that dealt with each issues specifically. In other words, E48 would result in a comprehensive standard as a matter of form without comprehensive substance. If E48 was split into two standards, the steering committee would be criticised that they could produce only a partial disclosure standard for accounting for financial instruments after all. In either case, the credibility of the IASC might be seriously questioned. In the end, the steering committee decided to split the E48 into two separate standards.

The IASC board authorized the steering committee's decision to split E48, and the disclosure part of E48 was approved to be the IAS 32 "Financial Instruments: Disclosure and Presentation" in March 1995. Two months later, the IASC board decided to set up the second steering committee to deal with issues related to recognition and measurement. The second steering committee produced the IASC/CICA DP.

3.4. Time Pressure: the IOSCO's Core Standards and the G4+1

Some of the participants of the first and second steering committees started to question a major premise of their approach. The inductive approach presumed that there was an appropriate mixed-attribute measurement model that was acceptable to most of the IASC constituency. That premise was seriously questioned by the harsh responses that the steering committee received more than once. It became apparent that the steering committee had reached an inconclusive impasse and could not find a way out as long as they stuck to the inductive approach.

The immediate situation that leads to the conversion to the comprehensive fair value measurement model was the failure of the two exposure drafts, i.e., E40 and E48. Both exposure drafts received harsh criticisms. On the one hand, they were attacked because they introduced too much room for fair value measurements, on the other hand, they were criticized because of the extent to which

historical cost measurements remained. The body of comment letters showed that the constituency to whom the working group had to appeal was seriously divided. Divided constituency meant that the political success of the mixed-attribute measurement model was very unlikely. The mixed-attribute measurement model presupposed that a politically acceptable point of compromise existed among the constituency. As long as the working group adhered to the mixed-attribute measurement model, there was little chance for the accounting standards for financial instruments to be authorized by the board.

A full historical cost model was no alternative because it was where the working group departed from. The mixed-attribute measurement model was proven to be politically inadequate. Some members of the working group felt they were going nowhere. Indefinite postponement was a very likely outcome, if it had not been for external pressures on the IASC.

The IASC was at a critical junction between success and failure in the middle of the 1990s. On one side, there was the IOSCO, the International Organization of Securities Committees, who had been cooperating with the IASC to set global accounting standards. On the other side, there was the G4+1, a group of standard setters from the US, the UK, Canada, Australia, and the IASC as an observer. The G4+1 had the potential to take the place of the IASC.

In August 1993, the IOSCO drew up a list of a core set of standards that had become one of the criteria for the IASC to obtain the IOSCO's endorsement. It was quite shocking for the IASC that the core standards included a comprehensive standard for financial instruments, because at that time no standard setters in the world succeeded in developing such a standard (Carsberg 2001). The listing of the core standards was IOSCO's response to the completion of the comparability/improvement project on which the IASC had worked since 1987. The lists of core standards meant that the bar was raised after the race for some of the IASC board members (Interview 16 May 1991). To complete the core standards became IASC's top priority.

In October 1992, the second conference of national, regional and international standard setting bodies was held in Nowalk. The G4+1 was formed at this occasion. All the participants were standard setters of Anglo-Saxon countries because one of the criteria to join the group was that all participants had to share a similar conceptual framework. The G4+1 had been very productive since the beginning and produced a number of influential papers and reports. The IASC acknowledges activities of the G4+1 and it greatly influenced the choice of agendas at the IASC board (IASC 1999, IASB 2001). The relationship between the IASC and the G4+1 was very delicate. On the one hand, the participants of the G4+1 were also very important members of the IASC. On the other, there was a contest over the initiatives to lead global standard setting (Arai *et. al.* 1993).

Both the IOSCO's list of core standards and the productivity of G4+1 exerted time pressure on the IASC. Among the standards in process, the Accounting for Financial Instruments was one of the most time-consuming, tough standards. Indeed, the core standards were completed when the Accounting for Financial Instruments was approved by the board in December 1998.

3.5. Deductive approach: comprehensive fair value measurement model

One of leading participants at the second steering committee comments "We started to think, what's wrong with full fair value accounting?"[19] This new possibility came with a new approach to the problem of setting the standard for financial instruments. A deductive approach took the place of the inductive approach. At this time, staff members of the new steering committee started to consult disciplines other than accounting; "we looked at what financial theory says."[20] There seemed to a shift of emphasis from practices and external validity to theory and internal consistency of the standard.

The IASC/CICA DP rejected mixed-attributes measurements models and instead proposed a comprehensive fair value measurement model for all financial assets and financial liabilities[21]. All financial instruments should be valued at their fair value (IASC/CICA, 2000, pp.20-21), and all gains and losses arising from changes in the fair value of financial assets and financial liabilities are income, and should be recognised as income immediately when they arise (IASC/CICA, 2000, pp.20). The IASC/CICA DP was praised as one of the best arguments done by the IASC by several board members of the IASC[22].

Around the time the IASC/CICA DP was published, a number of standard setters, including the FASB and ASB, started to view the Comprehensive Fair Value Measurement Model as the ultimate goal for the accounting for financial instruments (ASB, 1996, IASC, 1998, FASB, 1998, par. 334, Skinner & Milburn, 2001, pp.362-363)[23].

4. The Logic of Comprehensive Fair Value Measurement Model

In October 1997, major standard setters around the world agreed to establish the JWG. The JWG's objective was to develop a Draft Standard and Application Supplement on financial instruments and similar items that are (a) comprehensive; (b) consistent with both relevant conceptual framework concepts

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[19] Interview (6 September 2001)

[20] Interview (6 September 2001).

[21] Interests in subsidiaries, associates and joint venture, and employers' obligations under employee stock option and stock purchase plans are excluded from the scope of the project (IASC/CICA 1997: 19).

[22] Interviews (2 May, 16 May, 25 May, 29 May 2001).

[23] The following analysis focuses on the IASC/CICA DP and the JWG RP for they are most consistent with the ultimate goal, even though they are not authorized papers at the board level. Because this current paper is aiming at exploring normative consequences rather than behavioural consequences, it is more relevant for us to see what has become to be seen theoretically appropriate rather than to see the output that many of the standard setters view as political compromise. Our interviews are limited to those in Anglo-American countries. This causes serious limitation on the significance of this paper, because it is non Anglo-American deligates, notably Germans, French and Japanese, who resisted *theoretically* against the Comprehensive Fair Value Measurement Model.

for financial reporting and accepted economic principles evident in capital markets and finance theory; and (c) capable of reasonable implementation. (JWG, 2000, p.149).

The JWG published a recommendation report on Accounting for Financial Instruments in December 2000 (JWG RP). The IASC/CICA DP is the primary basis for the JWG's considerations (JWG, 2000, p.5). The basic structure of the JWG RP is very similar to that of the IASC/CICA DP. Indeed basic causal logic addressed by the JWG RP to support the Comprehensive Fair Value Measurement Model is identical to that found in the IASC/CICA DP.

The primary conceptual advantages that the measurement of financial instruments at fair value has are:

(a) Fair value reflects the market's assessment of the effects on financial instruments of current economic conditions, and changes in fair value reflect the effects of changes in those economic conditions when they take place. This follows from the expectation that the fair value of a financial instrument determined in competitive, open market economies embodies all available information up to the measurement date.

(b) Following from (a), fair value provides a better basis for prediction than other measures. The fair value of a financial instrument represents the present value (taking into account all available information) of its expected cash flows discounted at the current market rate of return for commensurate risk. Thus, fair value embodies the market's expectation that the fair value of the instrument will increase over time at that market rate. As a result, if an investor knows the fair value of a financial instrument and has information about its essential terms and risks, he or she has the basis for evaluating the market's expectations. JWG (2000, pp.150-151)

Causal logic for the Comprehensive Fair Value Measurement Model can be summarized as follows: in the ideal world of competitive open market economy, current market price (whose generic form is supposed to be Fair Value) reflects all available information. Therefore Fair Value is both the most up-to-date information and the present value of and financial instruments' expected cash flows discounted at the current market rate of return for commensurate risk. Thus Fair Value has better predictive power than other measures.

Causal logic is stated to be derived from the financial theory according to the IASC/CICA DP. The description of causal logic is followed by: "(t)his is the essence of 'efficient' capital market theory. This is not just one theory among many, but is accepted to be theory in which developed financial markets work." (IASC/CICA, 1997, p.84, par.5.2.9). The conceptual case for fair value measurement of financial instruments is supported by a growing body of market-based empirical research according to the JWG RP (JWG, 2000, p.153). A reference was made to Linsmeier *et. al.* (1998), which summarizes the results of market-based empirical research as:

The first set of tests focus on determining if fair values of financial instruments are more closely related to stock prices than alternative values such as historical cost or lower of cost or market. Stock prices are used because they measure the market's perception of the future cash flows of a firm. If stock prices are more closely aligned with fair values than with

some alternative measure of value, then one can conclude that the market considers the disclosed fair values to be more relevant and reliable for developing estimates of future cash flows (i.e., value relevant). If one also assumes that the stock market is efficient, as is commonly the case in academic research, then the stronger association between fair values and stock prices cannot be due to investors who are fixated on accounting disclosures. Under these circumstances, one can conclude that fair values are relevant and sufficiently reliable to be recognized on the balance sheet. (Linsmeier et. al., 1998, p.91, The underline added by the author of this paper)

Any deductive approach necessitates a certain axiomatic assumption to start with. The case of the Comprehensive Fair Value Measurement Model holds that the equity market is efficient as the fundamental axiom, not only in theory but also in order to operationalise empirical research. The informational efficiency of the fair value (current market price) is *theoretically* derived from an ideal world of a competitive open market economy, in which another set of axioms are embraced (see Godel's Incompleteness Theorem) including that of an economic man who is instrumentally rational.

Although the precise meaning of rationality in causal logic is unclear and ambiguous, whether rationality is assumed at the collective level or at the individual level, it plays a vital role in making inference possible. That most up-to-date information means that the information is the present value of its expected cash flows discounted at the current market rate of return for commensurate risk. Efficiency has to contain a certain rationality. Modern financial theory provides a theoretical basis for such interpretation. Within the context of modern financial theory, "up-to-date information" means not only the latest but also the most rational information in a sense that it is unbiased from the norm (Hines, 1984).

Both in theory and in empirical studies, we find that market efficiency is assumed, rather than tested. The body of empirical research shows some kind of value relevance to fair value information[24], but in order to interpret the test results, efficient market hypothesis must be assumed. It is not very easy to make inferences from empirical test results for a standard setting point of view without assuming that the market is informationally efficient so that the relevant information is quickly and unbiasedly reflected in fair value. In other words, the validity of the whole conceptual and empirical arguments advocating for the comprehensive fair value measurement model depends upon whether one accepts the legitimacy of the market efficiency.

However hypothetical the concept of market efficiency is, the concept seems to have obtained an uncontestable status among Anglo-American standard setters. Although among individual cases, market efficiency is reasonably questioned and balanced against a more realistic view (*cf.*, Skinner & Milburn, 2001, pp.357-358), in general market efficiency is uncontestable because it is embedded at the level of fundamental causal logic that justifies the Comprehensive Fair Value Measurement Model. The following comment that we heard from a participant of both the steering committee and the JWG is revealing:

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[24] For growing literature on the anomaly which questions the efficiency of the market, see for example, Ou

> One of the comments we hear quite a lot is that it (fair value) will not give users useful information, and they will not understand the information and they will not be able to use the information to future cash flows, future earnings. That is a quite interesting argument, really, *because one of the things that we have almost taken given as an absolute truth is that fair value being up-to-date information, it ought to be.* Maybe there are problems in implementing it, *in theory it ought to give users better information.* (Interview 2nd May 2001, Parenthesis and the emphasis added by the author)

5. Usefulness of Research

Since the early 1970s, several influential accounting researchers have suggested that the accounting method that produces information with the highest association with security prices should be the adopted method (Gonedes, 1972, Beaver, 1972, Beaver and Dukes, 1972, Gonedes and Dopuch, 1974). Their arguments are based on the concept of market efficiency. Although arguments over appropriate definitions of market efficiency exist (e.g., Fama, 1970, Beaver, 1981), essential features of the concept of market efficiency are rapidness and unbiasedness (Hines, 1984). Markets are informationally efficient when prices reflect available information both rapidly and unbiasedly.

EMH as a Working Hypothesis

A great deal of empirical researches was carried out using the market efficiency as a working hypothesis. Quite a few of them assessed the usefulness of accounting numbers on their equity market value association, for standard setting purposes[25]. The association criterion is the benchmark for the appropriateness of standards. The result of these empirical researches is infused into the standard setting process as is described in the previous section. However, the relevance of this type of literature for standard setting process is questionable; firstly because the relationship between the association criteria and the stated objectives of standard setters is often unclear if not inconsistent[26]; secondly because much of the empirical research utilizes valuation models whose input has no specified links with accounting numbers; and thirdly there are a variety of significant econometric issues (Holthausen & Watts, 2000).

Much of capital market research employs some kind of market efficiency, or something more stronger, as a working hypothesis. For example, in an influential paper by Barth, which is explicitly motivated for a standard setting purpose and tries to differentiate the value relevance and reliability of accounting information, the approach that "views accounting measures as variables measured with error

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& Penman (1989), Ball (1992) and Brawn (1994).

[25] These type of empirical research may be called value-relevance literature, which is review by Holthausen & Watts (2000)

[26] Most literature is only concerned with association of equity prices whereas one of the objectives of standard setters is to establish general-purpose standards. At one end of the spectrum we find impossibility theorem which states that no set of standards facilitate the diversity of information needs in general (Demski, 1973). At the other end of the spectrum we find the belief that information needs of

and the amounts implicit in share prices as 'true' variables'" is taken(Barth, 1994, p.20). The assumption that the amounts in share prices are the "true" variables is stronger than market efficiency: the market's estimates are not just unbiased, they are error-free (Holthausen & Watts, 2000, p.13).

The confusing nature of the concept of market efficiency is traced by comparing two review articles: Fama (1970) and Fama (1991). Fama (1970) classifies the efficiency tests into three categories depending on the information subset used to define market efficiency. They are weak form, semi-strong form, and strong form efficiency. The information subset of the weak form efficiency is historical prices. Semi-strong form efficiency reflects all publicly available information. And Strong form efficiency is tested against all available information.

Fama (1970) concludes that the efficient market model stands up well. The results of weak form tests of the efficient market model "are strongly in support" (Fama, 1970, p.414). Semi-strong form tests "have also supported the efficient markets hypothesis" (Fama, 1970, p.415). As for the strong-form efficient markets model, it is probably best viewed as a benchmark to measure deviations from market efficiency. Fama (1970) argues that there are only corporate insiders and specialists who have monopolistic access to information, and that there is no evidence that deviations from the strong form of the efficient market permeate down any further through the investment community. Fama summarizes that "(I)n short, the evidence in support of the efficient markets model is extensive, and (somewhat uniquely in economics) contradictory evidence is sparse." (Fama, 1970, p.416, parenthesis in original)

A sequel to the original review article by Fama was published in 1991, "Efficient Capital Markets: II" (Fama, 1991). More reserved evaluation of the EMH is provided in the ECM II. As was demonstrated in Grossman and Stiglitz (1980), because of the existence of information and trading costs, the costs of setting prices to reflect information are surely positive, therefore a simple and strong version of the market efficiency hypothesis, i.e., security prices fully reflect all available information, is false. Instead, following Jensen (1978), a weaker and economically more sensible version of the efficiency hypothesis says that prices reflect information to the point where the marginal benefits of acting on information do not exceed the marginal costs.[27]

However, according to Fama (1991, pp.1575-1576), the main obstacle to inference about market efficiency is the joint-hypothesis problem. Efficiency must be tested jointly with some model of equilibrium that defines the way in which a certain information subset should be reflected in price. "We can only test whether information is properly reflected in prices in the context of a pricing model that defines the meaning of "properly." In short, "market efficiency *per se* is not testable." It summarized that

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equity investors satisfy most of the other users needs (IASC, 1989).

[27] Marginal costs of acting on information include the cost of learning the information. In the case of event studies, sometimes the evidence of anomaly against market efficiency is attributed to the cost of learning (Brown, 1994). We will distinguish the cost of learning the event and the cost of learning how to learn the event. The latter cost is the concern of this paper.

"the market efficiency literature should be judged on how it improves our ability to describe the time-series and cross-section behaviour of security returns."

This is why we call the EMH a working hypothesis. We maintain the hypothesis to enrich our knowledge beyond the validity of the working hypothesis. "Rationality is not established by the existing test, however, and the joint hypothesis problem likely means that it cannot be established. Still, even if we disagree on the market efficiency implications of the new results on return predictability, I think we can agree that the tests enrich our knowledge on the behavior of returns across securities and through time." (Fama, 1991, p.1577). On cross-sectional return predictability Fama says that "this work does not place itself in the realm of tests of market efficiency, but this just means that efficiency is a maintained hypothesis. Depending on the emphasis desired, one can say that efficiency must be tested conditionally on an asset-pricing model or that asset-pricing models are tested conditionally on efficiency."(Fama, 1991, p.1589)

The difficulties of inferring empirical results acknowledged in Fama (1991) are also discussed differently in Hines (1984). Hines (1984) argues that (1) problems with using market reaction (non-reaction) as a surrogate for stock market effects (no effects); (2) problems with using market reaction (non-reaction) as a surrogate for information content (non-content) and/or usefulness (non-usefulness); (3) inadequacies of market reaction (non-reaction) as a surrogate for stock market effects (no effects) and/or information usefulness (non-usefulness) due to low power of tests relative to small magnitude of effects being studied, and (4) difficulties in interpreting a market reaction (non-reaction). Some of the criticisms have become less relevant because of the development in empirical studies that have taken place since then, but others are still very important.

For the following discussion it is relevant to note Hines' first criticism concerning the stock market effects (non-effects). Hines (1984) argues that market efficiency does not imply market omniscience, because share prices only reflect a consensus of shareholders' *expectations* about the ultimate effects of the change on the value of a firm – *not* the actual *effects* of the change. "Since the unanticipated consequences of an accounting standard may be significant, standard setters should not assume that a market non-reaction necessarily implies that a standard has no economic effect and/or no stock market effect, or conversely, that a market reaction captures the ultimate share price effects of a standards" (Hines 1984: 7). Hines (1984) distinguishes between what we call subjective and objective concepts of interests, which will be discussed later.

A Deviants' View of Market: Hayek (1946)

A fundamental attraction to the view that sees the market as an unrivaled information processing mechanism of society can be found in Hayek's "The Use of Knowledge in Society" (Hayek, 1946). Hayek is one of the forerunners who shared a vision to see the price system as a mechanism for communicating information. The ability of the price system to inform is emphasized by Hayek. However, it is not efficiency, but the decentralized nature of the price system that is the focus of "The Use

of Knowledge in Society".

His argument is that because knowledge of the relevant facts is dispersed among many people, and because the economy should adapt to changes in the particular circumstances of time and place, the ultimate decisions must be left to the people who are familiar with these circumstances. He contends, therefore, "(w)e must solve it by some form of decentralization" (Hayek, 1946, p.524). Decentralization is needed to ensure that local knowledge will be promptly used. The price system makes it sufficient for market participants to know enough of the events that happen beyond the horizon of their immediate knowledge if price changes are observed. Individual participants need to know prices in order to be able to take the right action (Hayek, 1946, pp.526-527). "Fundamentally, in a system where the knowledge of the relevant facts is dispersed among many people, prices can act to coordinate the separate actions of different people in the same way as subjective values help the individual to coordinate the parts of his plan." (Hayek, 1946, p.526)

The article, "The Use of Knowledge in Society," was written in the backdrop of Socialist Calculation (economic planning) Debate.[28] It is quite ironic for Hayek that both his own argument and neoclassical thought provide legitimacy for the free market economy even though the two theorizations are not compatible with each other. Hayek (1946) tried to rebut the neoclassical way of theorizing for its lack of capacity to treat historical time. The theoretical basis of the assumed causality in the Comprehensive Fair Value Measurement Model is apparent in the way time is treated. It is unequivocally neoclassical. Within neoclassical economics, historical time is ignored (Robinson). Instead "the future is summarized into the present through rational expectations" (Tinker, *et. al.,* 1984, p.85). This methodological incapacity of the neoclassical framework to analyse the evolutionary processes was what Hayek argued against.

Hayek's theory of knowledge in the Market Economy is not logically compatible with the neoclassical rational market theory. If the market is rational, equilibrium remains stable unless external shocks occur. If the market was efficient, those external shocks should immediately lead the economy to a new equilibrium point. There is no room for historical time, in which local knowledge may be able to play its part, in the neoclassical analytical framework because the efficient market replaces it. Paradoxically, if a market is truly efficient, we do not need to have decentralized information-processing mechanisms to ensure the use of local knowledge.

An advisor to a standard setting body told us the way in which modern financial theory, the concept of efficiency in particular, is understood by the standard setters:

> I do not think all of standards setters understand efficient markets in the sense that financial academics do. I think they,

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[28] The debate resulted in proving that calculating economic needs a socialist system is identical to finding the equilibrium in a general equilibrium theory. The impossibility of individual computational power in both economic systems are proven by evolutionary economists (Shiozawa, 1992).

use the term "efficient" to mean that the markets function efficiently. . . I think that deep and liquid is what they are really talking about.[29]

If the deep and liquid market that functions efficiently is regarded in the same light as the efficient market, Hayek's theoretical admiration of the market economy should easily be reconciled with the neoclassical view without confronting logical tensions. One does not need to understand the concept of efficiency to appreciate it because the allure of the concept derives directly from the image of free and well-functioning markets.

6. Educating the Users

One of the messages that is derived from the Comprehensive Fair Value Measurement Model is "not taking a risk is risky". JWG states that "under the fair value model for financial instruments, financial statements reflect the results of taking fair value risk" (JWG, 2000, p.156). A new risk definition is provided by the Comprehensive Fair Value Measurement Model. This affects the way in which financial statements are interpreted. An illustrative example is a comparison between floating rate and fixed rate assets and liabilities. According to the new risk definition, floating rate financial instruments are less risky than fixed rate financial instruments, because the former moves in line with the market and the market is regarded as neutral and unbiased in the model. In the same manner, cash flow interest rate risk is not considered a decent risk any more, because it is only fair value that matters (JWG, 2000, p.156).

Whether or not "taking a risk is risky" or "not-taking a risk is risky" is not a value-free question. The answer depends upon the theoretical framework in which the question is handled, and upon the individual understanding of the situation in which the risk arises. Any risk concept should be theory-laden and context dependent. A particular type of risk concept, however naïve or sophisticated its outlook, is connected to a particular understanding of the world. This time, it is concerned with that of financial theory.

The risk definition is universally applicable in the sense that the modern financial theory disembed risk from concrete time and space. Risk is defined independent from local contextual knowledge. The abstract modern financial theory sets up the stage that is the context in which risk is interpreted. A fabricated risk in financial statements is interpretable without actual context. Within the framework of the modern financial theory, the universal usefulness of fair value (risk) information is taken for granted by definition.

The meaning of fair value based accounting information was not obvious to users of the accounting information. A 1997 focus group survey conducted by independent consultants on behalf of the Association for Investment Management and Research, the FASB, and the Canadian Institute of Chartered Accountants shows mixed results (JWG, 2000, p.153).

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[29] Interview (29 March 2001)

In an interview with us, a standard setter lamented that "We have been quite puzzled as to why people run these arguments that fair value does not give useful information. Even more frustrating is when you go and talk to users they tend to say 'No, I would like to work with cash flows, and historical cost of current system is a little bit away from cash flows but if you take me to fair value, it is even further away'."

The meaning of fair value based accounting information has to be taught to the users. Indeed standard setters acknowledge that their success depends upon their ability to educate the financial community to change. A standard setter further revealed:

> What we recognize that we have to do is that if we decide these proposals are good proposal, *the part of the process is going to be teaching, educating the users.* Really opening their eyes to the potential to this new measurement basis. So that they then can sort of go 'oh, we see how to use it', then their demand for information will drag the proposals in the right direction. That is a really good example where we think that aspect is ought to be obvious but we are going to have to do a lot of work to get the users to see in that way. Proposals like this will, in the end, stand or fall on whether the users use the information, however good information is in theory, if the users say 'oh, I am used to steady increasing profit, why all this volatility, I do not understand what is going on. I cannot use it, instead let us look cash flow statement', then we are failed really.[30]

This comment coincides with ones made more than six decades ago. G. O. May once wrote that "We have to educate general investors that the balance sheets of modern large corporations do not and should not represent the their market value" (May, 1943, p.79). The regulatory efforts of the period studied by Merino & Neimark (1984) argues that they are trying to achieve trust and confidence in the market. From an insider's perspective, the way to rebuild confidence depends upon the ability of the regulators to educate investors on what to expect from and how to use financial statements.

The standard setters' efforts to institutionalize fair value measurements for financial instruments involve educational aspects, which is about learning to learn, i.e., double-loop learning (Bateson, 1956). The significance of learning how to use certain information is different from the meaning of learning certain information. It is more like an investment decision with long-term effects than volume or price adjustments in the short-term.

6.1. A Case of Objective Interests based on Subjective Interests

If the ultimate goal of standard setters is found in standardizing accounting practices, one of their roles should involve educational practices. Educating directors, accountants, investors and other users of accounting should be a part of their job. However, there is fundamental tension between the spirit of the free market economic theory, on which the Comprehensive Fair Value Measurement Model is based, and the pedagogical role of accounting standards setters that they have to play.

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[30] Interview (2 May 2001)

In order to illuminate the tension between the theory that guides standard setting and the actual roles that standard setters play, we should distinguish two concepts of interests; subjective interests and objective interests.

Mainstream economic theory translates interests into preferences, and preferences into choices, given the available options. Preferences are used as a synonym of goals, which are clearly within the purview of choosing agents. When individuals are observed to be choosing freely, it is deduced to be in their interests. In a market where no one is forced to sell or buy, agents freely choose from available options. In this sense, preferences of agents are revealed in their market transactions. This kind of interpretation of interest is termed "direct interest" (Caporaso & Levine, 1992, p.164) or "subjective interest" (Flathman, 1966, Balbus, 1971).

Another notion of interest is termed "real interest" or sometimes "objective" or "imputed" interest. Real interest is linked to "fully informed choice" (Connolly, 1983, p.68). Evidence of objective situations in which agents inhabit can be marshaled to demonstrate that an individual has an interest even if he is not aware of it, or even to show that what an individual thinks is in his/her interest is in fact not in his interest (Balbus, 1971, p.152).

The difference between the two notions of interests in practice can be found in the scope of evidence that is used to construct agents' interests. Subjective interests take individual actions *in the market* as the evidence as long as market transactions are not coerced against one's free will. The meaning of individual actions is interpreted with the help of the theory of market which assumes that normal transactions do not involve any coercion, therefore they are the results of individual free will.

When taken to its extreme, the subjective notion of interests enables Robert Nozick to argue that the recognition of the right to voluntary enslavement enhances our freedom when it is observed that individuals are freely choosing without coercion (Nozick, 1974, p.331). Against such contentions, an objectivist would argue that "subjectivist" interests of agents are merely deduced by observing Libertarian and subjective interests can be very different from objective interests for fully informed agents.

One of the paradoxes of the economic perspective in an accounting standards setting is that the perspective is used to establish the foundation from which to derive "objective interest" for agents, even though the perspective itself is founded upon the subjective notion of interests. Whereas the meta-theoretical foundation of conceptual framework is based on the notion of "subjective interests", standards should claim that they are based upon the "real objective interests" of agents in order for the standard setters to educate agents to use them. The case of comprehensive fair value measurement for financial instruments is an illustrative example where incompatibility between the subjective interest-based framework for accounting standard setting and the objective interest-based pedagogical efforts that are needed to make individual standards acceptable.

7. Conclusion: Enactment of a Positivist World View in Social Communication

The distinction between positivistic and normative research made by Beaver in his seminal work

is that the question of concern for positivistic research is "not whether investors *should* react to earnings but rather whether investors *do* react to earnings." (Beaver, 1968, p.68, original emphases) Our concern is not whether standard setters *should* react to financial theory and efficient capital market research but rather whether standard setters *do* react to financial theory and efficient capital market research, and what are the possible consequences of it if they *do* react.

What we have observed in this paper is that standard setters are trying to educate investors to learn to use fair value information because it is believed to have incremental information content, i.e., they believe that capital markets do react to fair value information. The belief that comprehensive fair value measurement model should be the ultimate goal for the accounting for financial instruments is, according to some standard setters, based on financial theory and the growing body of empirical research that assumes market efficiency.

Talking about the origin of the comprehensive fair value measurement model for the financial instruments project, a standard setter explained to us that the origin is derived from the academic world:

> I think that many academic people would say that all financial instruments should be measured at fair value, all assets and all liabilities including the company's own debt. I think the theoretical reason for doing that is actually very strong and actually very difficult to argue for some other cause. . . So, one school of thought, more theoretical school of thought if you would like, would say everything should be at fair value and there is no other possibility. That is what the predominant school in America believes, really. That is also what the authorities believe in Britain.[31]

Another standard setter mentioned also that the idea of origin came from theoretical works. He responded to our request to clarify what kind of theories influenced standard setters in the following way. "*It is based on, I suppose, analysis of capital markets.* If fair value is some sort of market value, then it appears to contain the most up-to-date information, market's perceptions and evaluation, today's evaluation of the information that ought to be."[32]

For the methodological framing of positivistic research projects, normative issues have to be externalized. Externalization of normative issues does not mean that positivistic theories are free from value-judgement. Just like any axiomatic theory that requires an externally given axiom, positivistic research programs require basic assumptions that exclusively deal with fundamental value judgements. The comprehensive fair value measurement model embraces the same assumption that most of capital market research is based upon, i.e., market efficiency lies at its core. An extreme (but logical) derivation from the market efficiency is the "Market cannot be wrong" (Brown, 1994). This is indeed a manifesto of one's belief. The normative consequences of efficient capital market research are vividly shown when we hear phrases such as those just quoted.

The concept of informational efficiency comprises both "rapid" and "unbiased". The latter

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[31] Interview (16 May 2001)

connotes with rationality (Fama, 1991). The results of event studies may support the efficient market hypothesis to the extent that the market absorbs information rapidly so that the price instantaneously reflects the latest information. It does not mean that the market is rational unless we use the modern financial theory to interpret the results.

Although the results of empirical studies, which in themselves are by no means uncontroversial, do not fully support the informational efficiency of the market, the basic assumptions of efficiency that are necessary for the Comprehensive Fair Value Measurement Model to make sense are endorsed by some standard setters and apparently endorsed and proclaimed in some of the draft papers. That does not mean that all standard setters are true believers of modern financial theory and efficient capital market theory. However, it is critically important for us to acknowledge that standards setters feel it difficult to rebut these contentions *theoretically*. In other words, the difficulties of implementing the Comprehensive Fair Value Measurement Model lie not on theoretical grounds but on political grounds. A standard setter explained by saying:

> I still think it will take quite a long time achieve it in practice, because I think that you have to have political acceptability for the standards. . . I think we are some way short of that. I think in America, there would be a very strong lobby from banking and other business people against full fair value accounting. I think that the same will apply in other countries and other parts of the world. The European commission is not in favor of it, Basle committee has expressed doubts about it, if you cannot get support from regulators, then it is difficult to push it thorough. . . I think its future is still a bit uncertain, but my guess, my personal guess would be that we might get an agreement on it in five years time.[33]

Another standard setter explained the feeling he had when he received the 1997 IASC/CICA DP: "I think that the discussion paper is maybe the best draft ever written by the IASC. It is well written, well argued. But I wondered how can we possibly implement those ideas?"[34] These comments show that the legitimacy of the Comprehensive Fair Value Measurement Model is theoretically indisputable among them, however politically difficult to implement.

Institutionalizing the Comprehensive Fair Value Measurement Model is an ongoing process and by no means finished. If the standard setters succeed in it, it means that basic value laden assumptions of the positivistic theories become more firmly embedded in accounting institutions. Even if they will not succeed readily, normative messages have been repeatedly delivered by the standard setters in the form of discussion papers and draft standards.

Positivistic theories externalize value-laden questions from their analytical framework by containing them in their basic assumptions. These basic assumptions have become accepted as absolute

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[32] Interview (2 May 2001)

[33] Interview (16 May 2001)

[34] Interview (29 May 2001)

truth among some of the standard setters. Their attitudes are implicitly and explicitly reflected in the documents issued by them. These materials convey value-laden messages repeatedly. This is not a mere coincidence, because the fate of standard setters depends upon how well they succeed in teaching the theoretical framework to the users. This implies that we are already observing the standard setters endeavour to morally educate people.

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